STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
US TELECOM, INC.	:	DETERMINATION DTA NO. 820160
for Revision of a Determination or for Refund of of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1997 through February 28, 2002.	:	

Petitioner, US Telecom, Inc., 6500 Sprint Parkway, HL 5ATTX, Overland Park, Kansas 66251, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1997 through February 28, 2002.

On February 7, 2005 and February 16, 2005, respectively, petitioners, appearing by Audra Mitchell, Esq., and the Division of Taxation, appearing by Christopher C. O'Brien, Esq. (Susan Hutchison, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based upon documents and briefs to be submitted by June 3, 2005, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner's purchases of plastic telephone calling cards were properly excluded from sales tax as purchases for resale pursuant to Tax Law § 1101(b)(4)(i) or, alternatively, were exempt from tax as containers, wrapping and packaging materials purchased for use and

consumption in packing or packaging tangible personal property for sale pursuant to Tax Law § 1115(a)(19).

FINDINGS OF FACT

1. Petitioner, US Telecom, Inc., is a division of the Sprint Telecommunications Company, located in Overland Park, Kansas. Petitioner is a corporation engaged in the business of providing telephone service in New York State, which service is subject to tax under Tax Law Articles 28 and 29.

2. Petitioner's business activity includes selling prepaid telephone calling service. Petitioner uses plastic telephone calling cards to provide information concerning its prepaid telephone calling service to its customers, such as the transfer of the authorization code verifying payment for the telephone service and instructions, including codes for accessing the service.

3. Petitioner was the subject of a sales tax field audit covering the period March 1, 1997 through February 28, 2002. Upon audit, the Division determined no additional tax was due on petitioner's sales during the period in question. However, review of petitioner's asset acquisitions revealed additional taxable asset purchases in the amount of $374,276.71, with tax due thereon in the amount of $18,903.42. In addition, the Division's auditor also reviewed petitioner's expense purchase records for the test month of October 2000. As extrapolated over the audit period, this review resulted in additional taxable expense purchases of $2,066,210.90, with tax due thereon in the amount of $170,462.40. The additional tax due on expense purchases related to petitioner's purchases of the plastic prepaid telephone calling cards, including the printing, bundling, storage and packaging of such cards.

4. As a result of its audit, the Division issued to petitioner a Notice of Determination on November 28, 2003 assessing additional tax due in the amount of $189,365.82, plus interest, for the period March 1, 1997 through February 28, 2002.[1]

SUMMARY OF THE PARTIES' POSITIONS

5. Petitioner maintains that the plastic telephone calling cards are an integral part of the sale of the taxable telecommunications service it provides, without which the information necessary to access and utilize such service could not be provided. Petitioner points out that the cards are tangible personal property actually transferred to its customers, and argues that the cards are thus a part and parcel of providing the service and are part of what petitioner's customers pay for in purchasing prepaid telephone service.

6. The Division argues, in contrast, that the plastic calling cards are simply an incidental part of petitioner's primary business of supplying prepaid telephone service. The Division notes that petitioner is not in the business of selling plastic cards, that the information contained on the cards could be transmitted to petitioner's customers by means other than the cards, and thus petitioner's purchase of the cards from its supplier is not a purchase for resale but rather is a retail sale properly subject to sales tax.

CONCLUSIONS OF LAW

A. There is no dispute that petitioner's prepaid telephone calling service was subject to sales tax during the entire period under audit (Tax Law § 1105[b][1]). For the portion of the audit period prior to March 1, 2000, a retail customer's purchase of prepaid telephone calling

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[1] Petitioner raised no arguments against, and apparently does not dispute, the calculation method or the $18,903.42 tax liability determined with respect to asset acquisitions. In addition, petitioner does not dispute the use of a test month and extrapolation audit method with regard to expense purchases (its purchases of the plastic telephone calling cards), nor does petitioner dispute the resulting dollar amount of the tax calculated as due using such audit method ($170,462.40). Rather, petitioner challenges only the propriety of imposing tax on its purchases of the plastic telephone calling cards in question.

service (including service represented by prepaid calling cards) was not subject to New York State sales tax at the time of such purchase, but rather the tax was imposed at the time a taxable (i.e., intrastate) telephone call was made by the end user of the service. Pursuant to chapters 649 and 651 of the Laws of 1999, effective March 1, 1999, the manner of imposing and collecting the tax was changed such that sales tax was imposed at the time the prepaid telephone calling service (including service represented by prepaid calling cards) was sold to the retail purchaser. As a result, the individual telephone calls made using such a prepaid telephone card purchased on or after March 1, 2000 were not subject to sales tax when made (***see***, Tax Law § 1101[b][22]; § 1105[b][1][D]; [2][A]).

B. Petitioner's customers' purchases of prepaid telephone calling service were effectuated through the sale of prepaid plastic calling cards which included the necessary information, such as access and authorization codes, enabling such customers (the end users) to make telephone calls. The issue in this matter is whether petitioner's purchases of the plastic cards, containing the necessary information thereon allowing access to and use of the prepaid telephone service, may properly be considered purchases for resale. The Division posits that such purchases constitute retail sales to petitioner properly subject to tax, inasmuch as the cards themselves are not sold at retail by petitioner to its customers, i.e., petitioner is not in the business of selling plastic cards. The Division maintains instead that petitioner's primary business is selling taxable prepaid telephone service, and that the plastic cards are merely an incidental element of such business. Petitioner, in contrast, argues that such cards are an essential element of its business, that the cards are sold to its customers, and that its purchases of such cards were thus purchases for resale not properly subject to tax.

C. Since petitioner's purchases of the plastic prepaid telephone cards at issue here were sales (Tax Law § 1101[b][5]) of tangible personal property (Tax Law § 1101[b][6]) to petitioner, i.e., a person (Tax Law §1101[a]) for a purpose (Tax Law § 1101[b][4][i]), such purchases were retail sales unless they fall within one of the exclusions from the definition of a "retail sale" found in Tax Law § 1104(b)(4)(i).

Tax Law § 1101(b)(4)(i), in turn, defines a retail sale as:

> A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed *or* where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. (Emphasis added.)

D. Petitioner maintains that the use of the disjunctive word "or," specifically in the last part of Tax Law § 1101(b)(4)(i)(B), should be read to mean that the transfer of the purchased tangible personal property to the purchaser of a taxable service (here, the transfer of the plastic calling cards purchased by petitioner to the retail purchasers of the prepaid telephone calling service) allows for resale status on petitioner's purchase of the cards. In ***Matter of Helmsley Enterprises, Inc.***, (Tax Appeals Tribunal, June 20, 1991, ***confirmed*** 187 AD2d 64, 592 NYS2d 851, ***lv denied*** 81 NY2d 710, 600 NYS2d 197) the Tribunal stated:

> As a general rule, the maxim *expressio unius est exclusio alterius* is applied in interpreting statutes, so that where a law expressly describes a particular act, thing or person to which it shall apply, an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded [citations omitted]. The fact that section 1101(b)(4)(i)(B) excludes from sales tax only those purchases of tangible personal property used in conjunction with performing certain types of services specifically enumerated in the statute is convincing evidence that no other exclusions were contemplated under that section.

Petitioner's reading of the last part of Tax Law §1104(b)(4)(i)(B) fails to recognize that such provision does not speak to the purchase of *any* taxable service, but rather clearly refers back to the purchase of one of the six enumerated taxable services specifically identified in the earlier portion of the provision. Telephone service, including prepaid telephone calling service, is not one of the six services taxable pursuant to Tax Law § 1105(c) which are specifically enumerated in Tax Law § 1101(b)(4)(i)(B). Thus, petitioner's purchases of plastic cards, though transferred to the purchasers of the prepaid telephone calling service subject to tax pursuant to Tax Law § 1105(b)(1)(i), cannot qualify as a purchase for resale pursuant to Tax Law § 1101(b)(4)(i)(B).

E. In light of the foregoing conclusion, petitioner's claim for the resale exclusion must be found, if at all, under Tax Law § 1101(b)(4)(i)(A), which excludes from the definition of "retail sale" a sale of tangible personal property "for resale as such or as a physical component part of [other] tangible personal property . . . ." Since the plastic cards are not transferred as a "physical component part of [other] tangible personal property," but rather are transferred in conjunction with the purchase of a taxable service, the possible resale exclusion turns on whether the plastic cards may nonetheless be considered resold "as such." The Division argues, and at first look it would appear, that the exclusion would not apply since, as the Division points out, petitioner is not in the business of selling plastic cards. Rather, the Division claims that petitioner's provision of such cards to its customers is simply an incidental or ancillary part of petitioner's primary business of selling prepaid telephone service. Hence, resolution of the issue further devolves to whether the plastic cards are merely an incidental or ancillary part, as opposed to an essential or critical element, of petitioner's business of providing prepaid telephone calling service.

G. Petitioner analogizes its purchases of the plastic cards in question to the purchase of wrappers for hamburgers, "sleeves" for french fries, and cups for beverages used to package food sold by a fast food chain in ***Burger King v. State Tax Commn.***, (51 NY2d 614, 435 NYS2d 689). In ***Burger King***, the Court of Appeals held that the wrappers, sleeves and cups were not subject to sales tax when purchased by the fast food chain since they were bought for purposes of resale. The Court concluded that such items were purchased by consumers in conjunction with their retail purchases of the food items at the fast food restaurants, explaining that the Tax Law imposed sales tax on the sale of restaurant food and that the wrappers, sleeves and cups were a "critical element" of the final hybrid product (the combination of restaurant food and service) sold to consumers at retail. Petitioner likens its situation to the ***Burger King*** circumstances, and posits that the plastic cards are a critical element of what petitioner sells, such that its sales should be viewed as a hybrid transaction involving the sale of tangible personal property (the cards) and service (the telephone calling service). Under this view, petitioner maintains that the plastic cards are purchased for resale "as such," per Tax Law § 1101(b)(4)(i)(A), since they are a critical element of the taxable service sold and since the prepaid telephone calling service could not (like the food and beverage items in ***Burger King***) be transferred to and used by the purchasing customer without the transfer (sale) of the plastic cards.

H. In ***Burger King***, the Court recognized that the sale of the items of tangible personal property (the wrappers, sleeves and cups) were part of a "hybrid" sales transaction involving the elements of both service and the sale of restaurant food (defined at and taxable pursuant to Tax Law § 1105[d]) as distinguished from the sale of tangible personal property (defined at Tax Law § 1101[b][6] and taxable pursuant to Tax Law § 11105[a]). Since the items sold (wrappers,

sleeves and cups) were accompanied by restaurant food and not by tangible personal property, such items could not be considered resold as component parts of other tangible personal property per Tax Law § 1101(b)(4)(i)(A). However, the Court in ***Burger King*** went on to explain that the wrappers, sleeves and cups were not "inseparably connected" to the accompanying product being sold and thus, though part of a hybrid transaction, such items could be resold "as such." In so doing, the Court recognized the practical reality that the restaurant food in ***Burger King*** was contained within the wrappings, sleeves and cups, but for which the food could not have been transferred and delivered to the purchasing customers in the critical manner expected, to wit, provided with "speed, sanitation and portability." Hence, while viewing the transaction in total and as a whole, i.e., a hybrid transaction including the combined transfer of the purchased taxable personal property (wrappers, sleeves and cups), the product (food) and service, the Court nevertheless made it clear that it is not a requisite to a finding of a purchase for "resale as such" under Tax Law § 1101(b)(4)(i)(A) that the tangible personal property purchased must be resold "alone" and entirely unaccompanied by anything else. The Court in substance simply realized that fast food outlets do not sell, and their customers do not arrive seeking to buy, sleeves, wrappers and cups as separate items of tangible personal property. Hence, the Court recognized the nature of the items in question and that while such items were not sold traditionally "as such" they were nonetheless critical elements of the final hybrid of product and service sold to customers. Turning to the case at hand, the items sold (the plastic calling cards) were accompanied by taxable telephone service, as opposed to tangible personal property, and thus could not be resold as component parts of other tangible personal property per Tax Law § 1101(b)(4)(i)(A). At the same time, petitioner's customers do not seek to merely buy plastic cards. Thus, while the cards are not sold traditionally "as such" (i.e., as mere plastic cards), it is

appropriate to view their sale as part of a hybrid transaction wherein petitioner's customers purchase the cards "as such" and as an essential element by which the desired prepaid telephone service is conveyed in a manner so as to allow access, use and portability.

I. In view of the foregoing, it must be concluded that the plastic calling cards at issue in this matter were items essential and critical to petitioner's sale and delivery of the prepaid telephone calling service, and thus were purchased for resale as such by petitioner. That is, but for the plastic cards the prepaid telephone calling service would not be, practically speaking, either marketable to the public, accessible to the purchasing consumer, or portable. It is of no moment that the service could, theoretically, be delivered in some manner other than via the plastic cards, for the fact remains that petitioner chose its method of delivery and the tax consequences should be determined therefrom. Thus, the Division's suggestion that the service could have been delivered by the provision of the access code and other information via a piece of paper is irrelevant (and renders it unnecessary to delve into the issue of whether the piece of paper or other medium for delivery could, like the plastic cards, be purchased by petitioner for resale).[2] In simple fact, the plastic cards contain the information essential to enable the consumer purchasers thereof to access and utilize the prepaid telephone service and to do so whenever such service is wanted or needed. The plastic cards provide most notably, as in ***Burger King***, the expected and desired feature of portability. This feature alone would appear, self-evidently, to be a critical element and primary reason for purchasing a prepaid telephone service evidenced by a card easily transported and allowing for use of the service at times when

[2] The Division's reliance on 20 NYCRR 526.8(c)(2)(example 1) for support is unpersuasive. The cited example states that a corporation which has bonds printed must pay tax on the charges it incurs in purchasing paper, printing and signature services to create the bonds, since the bonds when issued as evidence of indebtedness are not items of tangible personal property being offered for sale. In contrast, petitioner here purchases and transfers to its customers an item of tangible personal property critical to the taxable service being offered for sale as opposed to the physical representation of an intangible, to wit, a debt obligation owed by the issuer of a bond.

the user was not at home or otherwise able to simply pick up the phone and dial. In sum, petitioner's purchases of plastic telephone cards were purchases for resale and not retail sales subject to tax.[3]

J. Petitioner's alternative argument that the plastic cards together with their accompanying packaging materials, informational or instructional information, and artwork are entitled to exemption pursuant to Tax Law § 1115(a)(19) is rejected. Tax Law section 1115(a)(19) exempts "[c]artons, containers, and wrapping and packaging materials and supplies, and components thereof *for use and consumption by a vendor in packaging or packing tangible personal property for sale*, and actually transferred by the vendor to the purchaser." (Emphasis added.) The cards in question do not constitute "cartons, containers, and wrappers and packaging materials . . . for use and consumption . . . in packaging or packing tangible personal property for sale . . . ." Rather, petitioner sells tangible personal property (the cards), as such, and as a means of accessing a prepaid telephone service. Hence, petitioner simply does not qualify for the noted exemption (***cf., Matter of Pharmacia & Upjohn Company***, Tax Appeals Tribunal, July 22, 2004).

K. The petition of US Telecom, Inc. is hereby granted to the extent that tax determined to be due on petitioner's expense purchases of plastic telephone calling cards ($170,462.40) is

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[3] The result reached here, and in ***Burger King,*** may be contrasted with that reached in ***Matter of Helmsley Enterprises, Inc. (supra)***. In ***Helmsley***, the Tax Appeals Tribunal concluded and the Appellate Division affirmed that the rental of a hotel room does not involve two transactions, to wit, the taxable rental of an unfurnished guest room (Tax Law § 1105[e]) and the taxable retail sale or lease of tangible personal property in the form of furniture, furnishings such as sheets and towels, and guest consumables such as soap, shampoo and stationery (Tax Law § 1105[a]). Rather, the taxable transaction was the service of providing for the overnight accommodation of patrons including not just an empty space (i.e., a room) but also, for a single undifferentiated charge, the provision of certain commonly expected incidental amenities such as guest room furniture, furnishings and consumables. Hence such items, unlike the wrappers, sleeves and cups at issue in ***Burger King***, were considered inseparably connected to the essential purpose of serving the comfort of the hotel guests, and their provision was not properly viewed as separate transactions such that the hotelier's purchases of such items could be considered purchases for resale thereof.

canceled, the Notice of Determination dated November 28, 2003 is to be reduced accordingly, the petition is otherwise denied, and the Notice of Determination, as so reduced, is sustained.

DATED: Troy, New York
December 1, 2005

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE